

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF KENTUCKY POWER)	
COMPANY FOR A CERTIFICATE OF)	CASE NO. 8271
PUBLIC CONVENIENCE AND NECESSITY)	

REVISED ORDER ON REMAND

BACKGROUND

On March 15, 1983, the Commission issued an Order on Remand granting Kentucky Power Company ("KPC") a certificate of convenience and necessity to purchase a 15 percent undivided interest in two 1300 megawatt generating units being constructed near Rockport, Indiana, ("Rockport") by the Indiana and Michigan Electric Company ("I&M Company"), a sister corporation of KPC. The certificate was granted on the basis of the following summary of findings of fact:

KPC needs additional generating capacity to meet its own demand;

the needed capacity can not be obtained by purchasing power from the AEP pool without jeopardizing KPC's membership in the pool;

the benefits received by KPC through membership in the AEP power pool are substantially greater than its obligation to provide generation capacity to meet its own demand;

KPC could best meet its need for additional capacity by purchasing an interest in Rockport; and

that for rate-making purposes, a spending limitation ("cap") of \$312 million should be imposed on construction expenditures to protect KPC against costly deferrals which could benefit the other owners of Rockport but be a detriment to KPC.

On May 12, 1983, the Commission granted KPC a rehearing to present additional evidence in support of its motion to modify the Order on Remand by allowing KPC to exceed the spending limitation of \$312 million "for good cause shown." An evidentiary hearing was held on June 28, 1983, and subsequent to the receipt of briefs, the case was submitted to the Commission on July 21, 1983.

On August 2, 1983, the Commission commenced a hearing in Case No. 8734, General Adjustment in Electric Rates of Kentucky Power Company. During the course of that hearing, extensive testimony was presented on KPC's construction program, in particular a soon to be completed 765 KV transmission line. KPC informed the Commission that although the transmission line was authorized in 1974 with the understanding that KPC would be reimbursed for 95 percent of the capital and operating costs, no such reimbursement would be received. Consequently, KPC intended that its rate-payers bear 100 percent of the cost of the transmission line, estimated to be \$123 million. The Commission determined that this new evidence could have a direct and substantial impact on both KPC's financial condition and its membership in the American Electric Power Company's ("AEP") Interconnection Agreement.

On September 20, 1983, the Commission ordered further evidentiary hearings in this case based on the new evidence presented in KPC's rate case. Recognizing that the Attorney

General's Office, Consumer Protection Division, ("AG") had been the only intervenor in this case, and that there were numerous active parties in KPC's rate case, the Order of September 20, 1983, established a procedure for intervention. Intervenor status was subsequently granted to the Office of Kentucky Legal Services, Inc., on behalf of John Henry Ward, Bert Diamond, Sada Crum and Concerned Citizens of Martin County ("Residential Intervenor"); and the Kentucky Industrial Utility Customers ("KIUC") on behalf of Air Products and Chemicals, Inc., Armco Inc., Ashland Oil, Inc., Huntington Alloys, Inc., and Kentucky Electric Steel Company.

DISCUSSION

At the hearing on February 16, 1984, Mr. Robert E. Matthews, President of KPC, testified that on January 20, 1984, KPC reached a new internal peak demand of 1033 megawatts.¹ This compares to KPC's generating capacity of 1060 megawatts. Compared to other electric utilities, KPC's reserves are extremely low. Most utilities plan to maintain capacity that exceeds their internal peak demand by 20 percent. Accordingly the Commission finds that KPC needs additional generating capacity.

KPC presented additional testimony on the issue of whether it could obtain its needed capacity by continuing to purchase power under the AEP pool agreement, in lieu of the outright purchase of a generating plant, without jeopardizing its membership in the AEP pool. A review of the evidence indicates that the Commis-

¹ Transcript, February 16, 1984, pp. 129-130.

sion's prior finding on this issue was erroneous. KPC's membership would not be jeopardized if it continued to purchase needed capacity under the pool agreement, although the other members could seek to change the present allocation of costs and benefits of the pool.²

The Commission has not heretofore seriously addressed KPC's ability to continue purchasing power under the pool agreement because of the prior finding that to do so would jeopardize KPC's membership in the pool. Having reversed this finding, *supra*, it now becomes necessary to fully analyze this alternative.

All of the intervenors advocated the position that KPC should continue to purchase needed capacity under the terms of the Interconnection Agreement. KPC insisted that this could not be done because no pooling arrangement could continue to exist if all members refused to provide capacity.³ However, KPC admitted that the Interconnection Agreement does not require the member companies to maintain any specific level of generating capacity.⁴ In fact, the Interconnection Agreement, through its provisions for capacity equalization charges, provides that a member can meet its own generation needs either by owning capacity or paying into the pool for it.⁵

² Abraham Gerber Prefiled Testimony, pp. 24-25.

³ Abraham Gerber Prefiled Testimony, pp. 8-12.

⁴ Transcript, January 11, 1984, Vol. II, p. 182.

⁵ Transcript, January 11, 1984, Vol. II, p. 41.

The Commission recognizes the principle that a power pool cannot exist if each member refuses to provide capacity. Although KPC stressed this principle as justification for its purchase of Rockport, the Commission finds such justification to be lacking. The AEP power pool is not in a situation where its existence is being threatened due to KPC's refusal to provide capacity. In fact, KPC admitted that the pool does not need additional capacity but has excess capacity.⁶ A review of the AEP system's projected peak loads and reserve margins confirms KPC's testimony.⁷ The Commission notes that since the in service date for Rockport Unit No. 1 is December 1, 1984, it is clear that I&M Company will add the Rockport capacity to the pool irrespective of whether KPC purchases 15 percent.

The Commission must now review the financial implications of KPC's two options, purchasing Rockport versus purchasing capacity from the pool. KPC's analysis shows unequivocally that it is less expensive, by tens of millions of dollars annually, to purchase capacity from the pool in lieu of buying Rockport.⁸ Purchasing capacity from the pool is less expensive because it is priced at the average embedded capacity cost of the surplus pool members. The embedded capacity costs are substantially lower than the incremental costs for new generation capacity due to

⁶ Vassell Direct 1/11/83, Vol. II, p. 83.

⁷ Exhibit GSV-6 (Revised).

⁸ KPC Attachment 1 and 2 filed in response to PSC Data Request of 12/2/82, Item No. 2.

inflation, high interest rates, environmental and pollution control costs, longer construction times and risks associated with fluctuating rates of load growth.

The only situation in which the purchase of Rockport may be economically justified is if assumptions are made regarding KPC's purchase in 1992 of a yet to be conceived generating plant in Kentucky. Although KPC made such assumptions to tilt the scales in favor of Rockport, the Commission must reject any reliance on those assumptions. From the outset of this case, KPC stressed that there were no commitments for generating capacity beyond Rockport and that any generating plant in Kentucky was beyond the planning horizon.⁹ Consequently the Commission finds that KPC should continue to purchase power from the AEP pool and not purchase 15 percent of Rockport. Further, KPC should take all steps necessary to recover its prior expenditures for purchasing Rockport.

KPC has stressed throughout this proceeding that it needs to purchase Rockport because it is the "fair" thing to do. Unfortunately, KPC's view of fairness can only be supported by abandoning the unambiguous language of the interconnection agreement and substituting implied obligations where none exist. The evidence clearly indicates that there is nothing fair about requiring KPC's customers to pay for Rockport when any needed capacity can be purchased at substantially lower costs from the pool. KPC should immediately start to do what is fair for its

⁹ Transcript, September 3, 1981, p. 111-112.

customers, which is to enforce the explicit terms of the Interconnection Agreement allowing the purchase of capacity.

Intervenors also suggested that KPC could take advantage of Section 5.7(ii) of the AEP Interconnection Agreement by purchasing capacity from outside the pool and making that capacity available to the pool. Such an arrangement would have to receive prior approval from a committee of the AEP companies. The AEP companies would be adversely affected by the addition of such outside capacity because the pool is projected to have adequate reserves for at least the next 5 years.¹⁰ Since the record will not support a finding as to either the availability of long-term firm capacity or the likelihood of its approval by the AEP companies, the Commission must conclude that the alternative presented by Section 5.7(ii) is not a viable option.¹¹

In its Order issued September 20, 1984, the Commission expressed an interest in determining whether KPC's transmission facilities provided sufficient benefits to the AEP system to relieve KPC of its obligation to own generation capacity. The Commission has found herein that the interconnect agreement does not obligate KPC to own any specific level of generation capacity. The absence of such a capacity obligation obviates the Commission's inquiry regarding ownership of transmission facilities.

¹⁰ Exhibit GSV-6 (Revised).

¹¹ Transcript, January 11, 1984, Vol. II, pp. 82-85.

The Commission specifically reverses and revokes all findings in its previous Orders inconsistent with the denial of a certificate to purchase Rockport. The denial of a certificate to KPC renders moot the Commission's findings in its Order on Remand imposing a spending limitation of \$312 million for inclusion in KPC's rate base.

In response to the Commission's Order of September 20, 1984, KPC presented testimony on the financial impact of, and future rate adjustments necessitated by, its proposed purchase of Rockport Units 1 and 2 combined with its other construction expenditures.¹² The Commission's denial of authority to purchase Rockport alleviates the Commission's concern with these issues.

The final issue for resolution is the legal argument, raised in the briefs of the AG and Residential Intervenors, that the Commission lacks jurisdiction under KRS 278.020 to adjudicate a certificate application when the facilities are already under construction. This argument was previously raised by the AG and overruled by the Commission's Order on Remand. KRS 278.020 prohibits regulated utilities from beginning construction of a facility prior to receiving a certificate of convenience and necessity. The record clearly shows that KPC has neither begun nor participated in any construction of Rockport prior to receipt of Commission authorization.

¹² Commission Order entered September 20, 1984, p. 6.

IT IS THEREFORE ORDERED that KPC's application for a certificate of convenience and necessity be and it hereby is denied.

IT IS FURTHER ORDERED that the Commission's Order on Remand entered March 15, 1983, be and it hereby is revoked.

IT IS FURTHER ORDERED that KPC shall take immediate action to recover its expenditures for Rockport.

Done at Frankfort, Kentucky, this 2nd day of August, 1984.

PUBLIC SERVICE COMMISSION

(Not Participating)

Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary